



Ontario

CANTR 35

M72

Government
Publications

Ministry of Treasury
Economics and
Intergovernmental
Affairs

Queen's Park
Toronto Ontario

March, 1974

MUNICIPAL FINANCE MANUAL

This is a copy of the revised Municipal Finance Manual. The Bulletins in this Manual reflect the municipal accounting principles and practices that have been adopted by the Ministry. They also reflect important changes in the requirements of this Ministry in the area of financial management. In particular, the restrictions on the use of reserves have been eliminated from Bulletin #4.

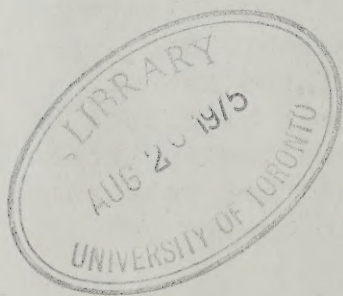
The revised Manual does not contain a Bulletin #1. A new version will be issued at the conclusion of certain studies now underway within the Ministry.

Note that Bulletin #2 contains an object classification of expenditure. While it is not required by the province at present, we expect it will be introduced in the near future.

This Manual does not include instructions for completing the Financial Report. The instructions, which are part of this new Manual, are supplied each year for each copy of the Manual. You should contact the Advisory Services Branch of the Ministry on the 6th floor, 56 Wellesley Street West, Toronto, Ontario, M7A 1Y7, so that your name can be added to the mailing list to assure you of this updating service.

Yours very truly,

E. A. Gomme,
Director,
Advisory Services Branch



BULLETIN

2

THE CLASSIFICATION OF EXPENDITURE

*a guide for
municipal treasurers and auditors*


Advisory Services Branch
MINISTRY OF TREASURY, ECONOMICS & INTERGOVERNMENTAL AFFAIRS.

1974



Contents

I. ACCOUNTING FOR EXPENDITURE	201
A. Introduction	201
B. The classification of expenditure	201
1. The functional classification of expenditure	201
2. The object classification of expenditure	201
a. <i>Current expenditure</i>	201
b. <i>Capital expenditure</i>	201
C. The measurement of levels of service	201
D. Basis of accounting	202
E. Treatment of special items	202
1. Expenditure on behalf of special areas	202
2. Netting of revenue and expenditure	202
a. <i>Amounts recovered from neighbouring municipalities</i>	202
b. <i>Charges for a special service</i>	202
c. <i>Amounts charged back under section 606 of The Municipal Act.</i>	202
II. THE STANDARD CLASSIFICATIONS	203
A. The functional classification of expenditure	203
B. The object classification of expenditure	208
1. Current expenditure	208
2. Capital expenditure	210



Digitized by the Internet Archive
in 2024 with funding from
University of Toronto

<https://archive.org/details/31761120631783>

I Accounting for Expenditure

A. INTRODUCTION

An effective and uniform classification of expenditure makes it possible to compare information on the financial statements of one municipality with others having similar characteristics. It also provides a consistent basis for reporting expenditure, no matter how diverse the organizational structures of different municipalities.

To compare expenditures between municipalities it is necessary to know both the level of service being provided by each municipality, as well as the cost of providing that service. Level of service can be measured only when non-financial data are considered – number of tons of garbage collected, number of police man-hours worked, and so on. There is a trend toward developing meaningful data of this nature.

B. THE CLASSIFICATION OF EXPENDITURE

Among the most common methods of classifying municipal expenditure are:

- classification by function – expenditure is grouped by the service or function performed
- classification by object – expenditure is grouped by the type of commodity or service purchased
- classification by organization – expenditure is grouped by the section over which each department head or committee is responsible for budgetary control.

Until now the Ministry has prescribed only classification of expenditure *by function*, which municipal management recognizes as the best way to classify financial information for purposes of comparison. This bulletin also outlines a standard classification of expenditure *by object*, both for current and for capital expenditures. As there is no standard municipal structure, no standard classification of expenditure *by organization* is possible.

1. THE FUNCTIONAL CLASSIFICATION OF EXPENDITURE

The functional classification adopted for use in financial reporting by Ontario Municipalities is shown on pages 203 to 207 of this Bulletin, with an illustrative list of services and expenditure included within each function. This classification shows the major functions of the municipality such as "Social and family services", "Environmental services", "Recreation and community services". In addition, each major function is analysed in greater detail. For example, the function "Social and family services" is further analysed into the sub-functions "General assistance", "Assistance to aged persons", "Assistance to children", "Day nurseries".

The illustrative listing of items under each sub-function on pages 203 to 207 is neither exhaustive nor is it intended as a detailed code of accounts. It is essentially a guide to help answer the question "In what classification is this item to be placed?"

It is recognized that the functions will not necessarily match the organizational responsibility pattern of your municipality, so it may be necessary to adapt your code of accounts to meet this classification.

2. THE OBJECT CLASSIFICATION OF EXPENDITURE

(a) CURRENT EXPENDITURE

The standard object classification of current expenditure adopted for use in financial reporting by Ontario municipalities is shown on pages 208 to 210 of this Bulletin, with an illustrative list of the major objects of current expenditure such as "Salaries", "Materials", "Services and rents". In addition, each major object is analysed in greater detail. For example, the major object "Salaries" is further analysed into the sub-objects "Salaries and wages", "Fringe benefits" and "Other allowances and benefits".

This object classification of expenditure is designed to be used in conjunction with the functional classification of expenditure. Within each function the separate objects of expenditure have to be identified.

Many municipal accounting systems already incorporate an object classification because this financial information is required for management purposes. Since external reporting by object will be required within the next few years, any future changes to your accounting system should include it.

(b) CAPITAL EXPENDITURE

The standard object classification of capital expenditure adopted for use in financial reporting by Ontario municipalities is shown on pages 210 to 211 of this Bulletin, with a list of the major objects: "Land", "Buildings", "Engineering structures", and "Machinery and equipment". Under each major object a general outline of the contents is given. This object classification of capital expenditure should be incorporated in the capital fund code of accounts because this information is reported on the schedule *Analysis of Capital Expenditure*.

C. THE MEASUREMENT OF LEVELS OF SERVICE

Municipal officials need to know both the level of service being provided as well as the expenditure incurred to provide that service. This information is necessary for compiling the annual budget, for measuring the effectiveness of established programs, for making meaningful comparisons with other municipalities, and so on. The same information is also needed

by the Government of Ontario as a basis for designing future subsidy programs. Level of service can be measured only in non-financial statistics – miles of road serviced by surface type, population and area served, and so on – defined in standard terms. The Ministry is gradually developing the non-financial reporting requirements for each municipal service.

D. BASIS OF ACCOUNTING

In general, the accrual basis is used throughout municipal accounting and financial reporting. Expenditure is recorded in the period goods or services are received, regardless of the date payment is made.

An exception to this general rule is the treatment of debt charges. Only those charges payable in the year are reported and no interest is accrued for the period from the last interest date to the end of the year.

Encumbrance or commitment accounting is highly recommended as a method of expenditure control within a municipality. Reflecting commitments in the accounts at the time the order is issued or the tender is let facilitates the control of expenditure within prescribed budgetary limits. However, for financial reporting purposes encumbrance accounting is not appropriate. Amounts reported in the annual financial statements should include only expenditure on goods received or services rendered during the year and should not include outstanding commitments at year-end.

E. TREATMENT OF SPECIAL ITEMS

1. EXPENDITURE ON BEHALF OF SPECIAL AREAS

A municipality often pays for a service provided within a defined area by raising the necessary revenues from the benefitting ratepayers. Types of special areas vary considerably, from a single service area (e.g. water, garbage collection) through a multiservice area with a limited number of inhabitants (e.g., a police village) to the provision of many services to a majority of the inhabitants in an urban service area.

The financial position and transactions for each area are reported on the appropriate schedule (*Continuity of the Account – for the Police Village or for A Special Area or for an Urban Service Area*). The expenditure made for the area is reported in the *Statement of Revenue and Expenditure* under the appropriate function or functions, and the accumulated surplus or deficit earmarked for the area is reported as part of the “Accumulated net revenue (deficit)” of the municipality.

2. NETTING OF REVENUE AND EXPENDITURE

It is accepted practice in municipal financial reporting to include revenue from all sources in total revenue and to

include all expenditures in total expenditure. However, to reflect the actual expenditure required to provide a service to a municipality:

- (a) *AMOUNTS RECOVERED FROM NEIGHBOURING MUNICIPALITIES* or an unorganized area for services provided beyond the boundaries of the municipality – such as fire-fighting services, water, transit – are deducted from the gross expenditure reported by the municipality for that function. Therefore the financial statements of the municipality providing the service report only the expenditure required to provide the service within the municipality. Also, the financial statements of the other municipality report only the expenditure required to provide the service within its boundaries.
- (b) *CHARGES FOR A SPECIAL SERVICE* that is incidental to a municipal service – for example, sewer connection charges, construction of approaches to driveways, snow-plowing driveways – are offset against the expenditure. Note however, that this practice does not include the netting of revenue received from licences and permits with the related expenditure.
- (c) *AMOUNTS CHARGED BACK UNDER SECTION 606 OF THE MUNICIPAL ACT* to bodies for which the municipality must levy rates are netted against the taxes written off; only the share borne by the municipality is reported.

II The Standard Classifications

A. THE FUNCTIONAL CLASSIFICATION OF EXPENDITURE

GENERAL GOVERNMENT

MEMBERS OF COUNCIL

Head of Council (chairman, mayor, reeve, warden) • Board of Control (controllers) • Council (aldermen, councillors).

GENERAL ADMINISTRATION

Officers and departments primarily involved in general administration and whose expenses cannot readily be allocated to any other functions (for example, chief administrative officer, clerk, treasurer) • Administrative buildings • Elections • Audit.

UNCLASSIFIED

Conventions and delegations • Public receptions • Other government expenditure • Administration (if not allocated above).

PROTECTION TO PERSONS AND PROPERTY

FIRE

Fire-fighting force (regular and volunteer) • Fire halls • Alarm system • Equipment • Hydrant rental • Auxiliary services • Fire prevention and inspection • Other fire protection expenditure • Administration.

POLICE

Police force • Offices • Lock-ups • Garages • Equipment • Police animals • Boards of police commissioners • Other police protection expenditure • Administration.

PROTECTIVE INSPECTION

Building and structural inspection • Fence viewing • Pest control • Weed control • Animal control • Other by-law enforcement (where not a public health function) • Other protective inspection • Administration.

STREET LIGHTING

Lighting streets, roadways, bridges, underpasses, etc. • Other street lighting expenditure • Administration.

UNCLASSIFIED

Emergency measures • Weigh scales • Flood control • Requisition of a conservation authority • Other protection expenditure • Administration (if not allocated above).

TRANSPORTATION SERVICES

ROADWAYS

Construction, reconstruction, repairs and maintenance of road surfaces, shoulders, roadsides, sidewalks and bridges • Winter maintenance
• Appropriations for suburban roads commission • Administration.

TRANSIT

TRAFFIC CONTROL

Parking control officers • Child crossing patrols • Pavement marking
• Traffic signals • Traffic signs • Railway crossing signals • Guide posts, guard rails and barricades • Traffic studies • Other traffic control expenditure • Administration.

PARKING

Contributions to parking authorities • Net cost – if any – of parking facilities.

DRAINAGE

Surface drains and ditches and storm sewers (where the storm sewer system is separate from the sanitary sewer system) • Surface drainage projects carried out under *The Drainage Act* • Other drainage expenditure
• Administration.

UNCLASSIFIED

Projects carried out under *The Tile Drainage Act*. • Docks and harbours
• Landing strips and airports • Waterways • Other transportation services expenditure • Administration (if not allocated above).

ENVIRONMENTAL SERVICES

SANITARY SEWER SYSTEM

Sanitary sewers – including storm sewers (where there is a combined storm and sanitary sewer system) • Public washrooms (other than those in parks or community centres) • Service agreements with the Ministry of the Environment • Construction and operating agreements with the Ministry of the Environment • Other sewer system expenditure • Administration.

WATERWORKS

GARBAGE COLLECTION AND DISPOSAL

Collection and disposal of garbage and waste (including incinerators, dumps and sanitary land fills) • Other collection and disposal expenditure • Administration.

UNCLASSIFIED

Other environmental services expenditure • Administration (if not allocated above).

CONSERVATION OF HEALTH

PUBLIC HEALTH SERVICES

Requisition of a health unit • Maternal care • Child care • School dental care • Communicable disease control (including immunization and vaccination) • Care of indigents (medical attention out of hospital, drugs) • Other public health expenditure • Administration.

PUBLIC HEALTH INSPECTIONS

Water • Food • Public eating places • By-law enforcement • Other public health inspections • Administration.

SUPPORT OF HOSPITALS

Grants to public hospitals • Contributions to municipally-owned hospitals.

UNCLASSIFIED

Ambulance services • Disinfestation of premises • Grants to voluntary health organizations • Other health expenditure administration (if not allocated above).

SOCIAL AND FAMILY SERVICES

GENERAL ASSISTANCE

Aid to unemployed and unemployable persons (living allowances, care of dependents, transportation and rehabilitation) • Aid to incapacitated persons (homemaking and nursing) • Aid to indigents (emergency dental treatment and burial) • Other general assistance expenditure • Administration.

ASSISTANCE TO AGED PERSONS

Homes for the aged • Housing for elderly persons • Home care • Social and recreational activities • Other assistance to the aged • Administration.

ASSISTANCE TO CHILDREN

Requisitions of Children's Aid Societies • Grants to voluntary organizations • Other assistance to children.

DAY NURSERIES

UNCLASSIFIED

Requisitions of district welfare boards • Contributions to a public housing agency • Grants to voluntary organization • Other social and family service expenditure • Administration (if not allocated above).

RECREATION AND COMMUNITY SERVICES

PARKS AND RECREATION

Parks • Flower gardens and floral displays • Playgrounds and amusement parks • Golf courses • Tourist camps • Community centres and halls • Skating rinks • Swimming pools • Stadiums and arenas • Exhibitions and fairs • Public celebrations • Assistance to sports teams • Requisitions of Boards of Parks Management • Grants to voluntary organizations • Other parks and recreation expenditure • Administration.

LIBRARIES

Requisitions of library boards • Other library expenditure • Administration.

OTHER CULTURAL FACILITIES

Zoos • Theatres • Auditoriums • Concert halls • Art galleries • Museums and archives • Historic sites • Requisitions of museum boards • Grants to voluntary organizations • Other cultural expenditure • Administration.

UNCLASSIFIED

Grants to cemeteries – whether owned by the municipality or not • Morgues • Other recreation and community service expenditure • Administration (if not allocated above).

COMMUNITY PLANNING AND DEVELOPMENT

PLANNING AND ZONING

The official plan • The planning department • The zoning by-law • Subdivision control • Requisitions of planning boards • Committees of adjustment • Other planning and zoning expenditure • Administration.

URBAN RENEWAL

Project surveys and studies • Acquisition and clearance of land • Installation of services • Other urban renewal expenditure • Administration.

INDUSTRIAL DEVELOPMENT

Acquisition and clearance of land • Installation of services • Industrial commissions and committees • Grants to boards of trade and chambers of commerce • Other industrial and commercial development expenditure • Administration.

UNCLASSIFIED

Tourist information and promotion • Other community planning and development expenditure • Administration (if not allocated above).

FINANCIAL EXPENSES

INTEREST ON TEMPORARY BORROWING

Interest on loans • Interest charged by school boards, counties or regions.

DISCOUNT ON TAXES

Discount allowed on taxes for amounts paid before the due date.

PROVISION FOR ALLOWANCES

Doubtful accounts • Uncollectable taxes • Losses on sale of property acquired for taxes • Other allowances.

PROVISION FOR RESERVES

Provisions for reserves which are not capable of being classified under any of the other functions (for example, working funds).

UNCLASSIFIED

Taxes written-off (where no allowance has been set up) • Foreign exchange losses (net of gains) on repayment of debentures to U.S. and overseas lenders • Bank service charges • Other financial expenses • Administration.

REGION/COUNTY – SHARE OF EXPENDITURE

The amount of the region/county requisition, including the region/county portion of supplementary taxes.

EDUCATION

Requisitions of public, separate and secondary school boards, additional payments such as the school board's share of supplementary taxes, trailer licence fees and pupil fees arising from municipal trailer camps.

UNIVERSITIES AND COLLEGES

Grants to universities and colleges.

OTHER

Contributions to electricity, gas or telephone enterprises to meet deficits or general expenses • Charges on liabilities issued to finance deficits, including refunding debentures • Advancement of agriculture • Reforestation.

B. THE OBJECT CLASSIFICATION OF EXPENDITURE

1. CURRENT EXPENDITURE

SALARIES

All direct payments to employees and all expenditure arising as a direct result of their employment.

SALARIES AND WAGES

Full-time, part-time, regular, over-time and other salaries and wages.

FRINGE BENEFITS

EMPLOYER'S CONTRIBUTIONS (INCLUDE EMPLOYER'S SHARE ONLY)

Canada Pension Plan • OMERS • OHIP • Other medical insurance plans • Other group insurance • Unemployment insurance • Workmen's compensation • Other employer's contributions.

OTHER ALLOWANCES AND EMPLOYEE BENEFITS

Clothing allowance • Moving expenses • Tuition fees • Subsidized board and housing • All other benefits paid through the payroll • All other taxable benefits.

MATERIALS

Cost of goods and utilities purchased. (Include delivery charges and provincial and federal sales taxes where applicable. Where materials, supplies or utilities are purchased directly by the municipality on behalf of third parties, such as drugs or clothing for welfare recipients, they should be included here rather than in "Transfers to persons").

Automotive supplies – fuels, lubricants, parts • Food, beverages and other edible supplies • Library supplies – books, magazines, records, films, tapes • Office supplies – office forms, stationery • Operating and cleaning materials – heating fuels, gravel, salt, sand, asphalt, paint, agricultural supplies • Personnel supplies – uniforms and clothing where purchased by municipality • Utilities – gas, water, electricity, street lighting when purchased from a hydro electric power commission, fire hydrant rental charges.

SERVICES AND RENTS

Cost of all purchased services, such as garbage collection that is contracted out, and all rents. When services or rents are paid for directly by the municipality on behalf of third parties, such as rent for welfare recipients, they should be included here rather than in "Transfers to persons".

SERVICES

Purchased repairs and maintenance of equipment, buildings, grounds, parks, roadways and bridges, etc. (include service contracts) ● Insurance premiums ● Communication costs – postage, telephone, telegraph, telex, express, cartage, etc. ● Purchased printing and reproduction services ● Travel expenses – car allowances, car rentals, taxis, meals, hotels, etc. ● Professional and consulting fees – accounting, auditing, data processing, engineering, legal, medical, planning, real estate, etc. ● Welfare services – housing, nursing services ● Trade and professional association membership and convention fees ● Other purchased services contracted out to commercial organizations – garbage collection, snow removal, etc.

RENTS

Land, buildings, equipment.

TRANSFERS TO A MUNICIPALITY'S OWN FUNDS, AGENCIES AND ENTERPRISES.

Transfers to or on behalf of any of the municipality's funds, local boards, agencies, or enterprises whose operations are reported on separate financial statements at the year end. (When the accounts of the operations of the entire municipality are consolidated, the transfers classified here are the amounts that have to be eliminated to prevent double accounting for expenditure.)

Provisions for reserves and allowances, and contributions to reserve funds, see **Bulletin 4, RESERVES, ALLOWANCES, RESERVE FUNDS AND OTHER SPECIAL FUNDS.** ● Capital financing from current revenue ● Taxes written-off, discounts for prompt payment ● Payments to municipal enterprises and other local boards – library board, parks boards, police commissions, transit authorities, parking authorities, et al. ● Debt charges paid from general municipal funds on behalf of local boards and enterprises – hospitals, transit authorities, community centres, et al.

TRANSFERS TO OTHER GOVERNMENTAL BODIES

Transfers to bodies that can requisition on the municipality (Include levies, requisitions, contributions, supplementary taxes, payments in lieu of taxes, share of trailer licence fees, etc. When the accounts of operations of all local government bodies in Ontario are consolidated, the transfers classified here are the amounts that have to be eliminated to prevent double accounting for expenditure. Do not include payments to other government bodies for goods and utilities, services, or debt charges, but classify them under the correct object. Such payments include payments to a hydro-electric power commission for street lighting, to another municipality for fire protection and to the Ministry of the Environment for sewage service or debt retirement).

Boards of Education ● Joint boards, health units, conservation authorities, suburban roads commissions, area planning boards, welfare boards, homes for the aged ● Children's Aid Societies ● Regional governments, counties, and other municipalities ● The Government of Ontario and its agencies ● The Government of Canada and its agencies.

TRANSFERS TO PERSONS AND NON-COMMERCIAL INSTITUTIONS

(Include only expenditure for which no goods or services are received in return. Payments to commercial organizations, other than privately owned transit authorities, are classified under the correct object) ● General assistance payments to unemployed and unemployable persons ● General assistance payments to the aged ● Grants to charitable organizations, hospitals if they are not a local board of the municipality, universities, colleges, recreation or cultural organizations, privately-owned transit authorities, et al.

DEBT CHARGES

Net long term liability payments. (Include only principal payments, contributions to sinking funds, and interest on long term debt as defined in **Bulletin 3, NET LONG TERM LIABILITIES**).

Interest on temporary borrowing ● Loss on foreign exchange ● Debenture discount ● Interest charges by other government bodies for late payment – school boards, regions, counties, et al.

2. CAPITAL EXPENDITURE

LAND

All expenditure for the acquisition of land and rights of way, including such incidental expenditures as legal, realty and appraisal fees, disturbance and relocation allowances etc. Where land is acquired with buildings on it, and these buildings are not required for the capital project (i.e. they are to be demolished) the expenditure on both the land and the buildings is included in the land cost, together with any demolition and site clearance expenses incurred.

BUILDINGS

All expenditure on the acquisition or construction of buildings (other than those included with land). Expenditures on elevators, boilers, heating, air conditioning and refrigeration equipment, electric lighting and control equipment, etc., is separated from the expenditure on buildings and reported as machinery and equipment. (Where it is not possible to separate this expenditure include them under buildings).

ENGINEERING STRUCTURES

All expenditure on the acquisition or construction of permanent structural works such as roads, sidewalks, bridges, traffic signs, park improvements and landscaping, incinerators, sewers, water mains, street lighting, swimming pools, et al. (Do not include here the land element, or any buildings).

MACHINERY AND EQUIPMENT

All expenditure on the acquisition of such items as trucks, graders, cars and other vehicles; office furniture and equipment; motors; pumps; electrical equipment; construction equipment, et al. (Elevators, heating, cooling and other types of equipment integral to most buildings are included here if they can be segregated from expenditure on the building).

BULLETIN

3

NET LONG TERM LIABILITIES

*a guide for
municipal treasurers and auditors*

Advisory Services Branch
MINISTRY OF TREASURY, ECONOMICS & INTERGOVERNMENTAL AFFAIRS
1974



Contents

I. GENERAL INFORMATION	301
A. Introduction	301
B. Types of long-term debt	301
1. Municipal debentures	301
(a) Instalment (serial) debentures	301
(b) Sinking fund debentures	301
(c) Term debentures	301
(d) Debentures redeemed by lot	301
(e) Refundable debentures	301
2. Long-term bank loans	301
3. Lease/purchase contracts	301
C. Assumed debt	301
D. Debt charges	301
E. Security of municipal debt	302
II. THE REPORTING OF LONG-TERM MUNICIPAL DEBT IN ONTARIO	302
A. Terminology used	302
1. Long-term liabilities	302
2. Net long-term liabilities	302
3. Charges for net long-term liabilities	302
B. Classification by function	303
C. Statements and schedules to be used	303
1. Statement of Revenue and Expenditure	303
2. Statement of Capital Fund Operations	303
3. Consolidated Balance Sheet	303
D. Proceeds from the sale of debentures	303
E. Treatment of special items	303
1. Agreements under <i>The Ontario Water Resources Act</i>	303
(a) Service agreements	303
(b) Construction and operation agreements	304
2. Net long-term liabilities and related charges incurred under <i>The Local Improvement Act</i> and section 362 of <i>The Municipal Act</i> .	304
3. Liabilities under <i>The Drainage Act</i>	304
4. Liabilities under <i>The Tile Drainage Act</i>	304
5. Liabilities payable in foreign currencies	305
6. Municipal grants to hospitals, universities and other institutions.	305

I General Information

A. INTRODUCTION

In order to provide an adequate level of service to their inhabitants, most municipalities make large capital expenditures. Since such expenditures vary from year to year, it is unreasonable to require ratepayers to pay for these major outlays as they are incurred. So it is customary for a municipality to spread the expenditure over a period of years by long-term borrowing.

As the demand for municipal services has increased in recent years, so has the need for municipalities to incur long-term debt. As a result the size of long-term debt outstanding has increased greatly. Consequently, a clear, accurate and consistent presentation of long-term debt is essential in municipal financial reporting.

B. TYPES OF LONG-TERM DEBT

There are several types of long-term debt available to Ontario municipalities. The major types are:

1. **MUNICIPAL DEBENTURES:** Debentures represent the most common form of municipal long-term debt. They are issued to the public or to other governments.

All municipalities* can sell:

(a) **INSTALMENT (SERIAL) DEBENTURES:** issued for a given number of years with a certain number maturing and redeemed by the municipality each year.

In addition, municipalities* with a population over 20,000 can sell:

(b) **SINKING FUND DEBENTURES:** issued to mature at a fixed future date. The municipality pays an agreed amount of money to a trustee each year. This money is invested and used to redeem the debentures when they mature.

(c) **TERM DEBENTURES:** issued as a combination of instalment and sinking fund debentures. Those debentures maturing and redeemed during the first few years of the issue are instalment debentures. At the end of this period, the municipality begins to make payments into a sinking fund which is used to redeem the remaining debentures, all of which mature at a fixed future date.

(d) **DEBENTURES REDEEMED BY LOT:** issued with a nominal date on which they must be redeemed. The municipality buys back a specified number of debentures each year. If the number required to be redeemed is not available on the open market, those to be redeemed are chosen at random; their holders are required to sell them.

(e) **REFUNDABLE DEBENTURES:** issued as instalment debentures with a series of early maturity dates for part of the issue. At the final maturity date, the balance of the issue falls due and is financed by the proceeds from a subsequent issue which must mature within the term originally approved by the Ontario Municipal Board (OMB).

2. **LONG-TERM BANK LOANS:** Bank loans are considered long-term liabilities if all three of the following conditions exist:

(a) the loan is made for capital purposes; and

(b) the bank cannot demand payment before maturity of the promissory note; and

(c) the municipality does not intend to issue debentures but has instead – with the approval of the OMB – set up a plan to repay the loan out of general revenues over a period exceeding one year.

3. **LEASE/PURCHASE CONTRACTS:** Municipalities sometimes enter into leasing contracts which provide for the acquisition of assets at the end of the lease period. Where there is a legally binding obligation on a municipality to acquire the asset, then the transaction should be treated as capital expenditure in the first year of the contract, financed by the incurrence of a long-term liability.

Only where a contract is definitely for a purchase is it reported as a liability. In other cases, such as when the municipality has an open option to buy the asset, exercisable at some stage of the lease, the obligation is reported, and then only if material, as a note to the financial statements.

C. ASSUMED DEBT

This type of debt arises when one municipality has issued the debt but another municipality assumes the obligation to repay a portion of the debt under some mutually acceptable formula. The municipality that issued the debt is legally responsible to the debenture holder. Examples include debt issued by regional governments on behalf of area municipalities; assumption of debt during annexations; the combination and redivision of municipalities during the formation of a regional government; and from debt issued on behalf of joint boards.

D. DEBT CHARGES

This term has a precise meaning in Ontario municipal financial reporting. Debt charges are annual charges required to service the long term debt of a municipality, including payments to retire the principal and to pay the interest.

*The legislation establishing regional municipalities allows only the region to issue debentures.

E. SECURITY OF MUNICIPAL DEBT

The primary responsibility for the repayment of municipal debt rests with the municipality issuing it. The security behind municipal debt is the ability of a municipality to tax the real property and businesses of its ratepayers and – in the case of persistent default of tax payments – to confiscate and sell for the value of the unpaid taxes the assessed real property and business chattels. It could be argued that in the case of utilities operated by a municipality, the debt is secured by the fixed assets of the utility. But since any deficits incurred by a municipal utility are met from general taxes, the fixed asset security is secondary to that provided by the municipality's power to tax.

II The Reporting of Long-Term Municipal Debt in Ontario

A. TERMINOLOGY USED

In reporting municipal debt in Ontario, it is necessary to understand that certain terms are not used in a general way, but each has a precise meaning. Three of these terms are similar and it is important to distinguish between them.

1. LONG-TERM LIABILITIES: The gross long-term debt incurred by the municipality both for itself and for other bodies.

2. NET LONG-TERM LIABILITIES: The effective debt position of the municipality or a local board. This term distinguishes real debt from the gross debt position described by the term "long-term liabilities". In other words, "Net long-term liabilities" are the debt figures adjusted to reflect the obligations assumed by or from other municipalities, governments, or agencies, after deducting the total value of sinking funds and funds held under *The Ontario Water Resources Act* for debt retirement.

The calculation is:

	\$	\$
Long-term liabilities outstanding, incurred by the municipality		xxx
Add –		
Long-term liabilities incurred by other municipalities and assumed by the municipality		xxx
		xxx
Deduct –		
Long-term liabilities incurred by the municipality and assumed by others	xxx	
Total value of sinking funds	xxx	
Amount held in debt retirement funds under <i>The Ontario Water Resources Act</i> for the municipality	xxx	(xxx)
		xxx
Net long-term liabilities		xxx

3. CHARGES FOR NET LONG-TERM LIABILITIES: The debt charges included in the *Statement of Revenue and Expenditure* for the municipality and each of its local boards. The calculation is:

	\$	\$
Charges for long-term liabilities incurred by the municipality		
Principal instalments on serial debentures, sinking fund contributions and contributions to debt retirement funds held under <i>The Ontario Water Resources Act</i>	xxx	
Interest	xxx	xxx
Add –		
Charges for long-term liabilities incurred by other municipalities and assumed by the municipality		
Principal	xxx	
Interest	xxx	xxx
		xxx
Deduct –		
Charges for long-term liabilities incurred by the municipality and assumed by others		
Principal	xxx	
Interest	xxx	(xxx)
		xxx
Charges for net long-term liabilities		xxx

B. CLASSIFICATION BY FUNCTION

In order to achieve the goals of clarity, accuracy and consistency in reporting, long-term debt and its related charges are classified according to the function for which the debt is incurred. This form of presentation has three advantages:

- It makes the reporting of debt charges consistent with the reporting of other types of expenditure.
- It reflects the impact of debt on the related functions of a municipality.
- It makes comparable the financial data of similar size municipalities.

C. STATEMENTS AND SCHEDULES TO BE USED

These comments are general in nature; a more detailed explanation of the contents of each statement or schedule, is given in the appropriate Instruction.

In the financial statements, debt and debt charges are reported net (see calculation page 302). However, the books of account from which the statements are prepared record full details of all the individual items used in the calculation of net long-term liabilities and their charges.

1. STATEMENT OF REVENUE AND EXPENDITURE

This statement reports only the debt charges borne by general municipal revenues. The debt charges are classified by function to reflect the total expenditure on each function. Because this statement does not analyse debt charges separately, a note to the financial statements is used to report them to the public. Full details of debt charges are given in the supporting schedules.

2. STATEMENT OF CAPITAL FUND OPERATIONS

This statement reports by source all capital financing transactions during the year; it does not report debt charges (which are reflected on the *Statement of Revenue and Expenditure*).

3. CONSOLIDATED BALANCE SHEET

This statement reflects the net long-term liabilities of the municipality and its local boards after eliminating any investments in the municipality's own debentures held in the consolidated funds. It reports the effective long-term liabilities to be recovered from future revenue; it does not reveal the legal responsibility of the municipality originally issuing the debt. This responsibility is disclosed in a note to the financial statements which reconciles the total long-term liabilities incurred with the net long-term liabilities. Details of the outstanding debt are reported in the supporting schedules.

D. PROCEEDS FROM THE SALE OF DEBENTURES

Debentures are reported as net long-term liabilities only when they have been delivered and the cash has been received for them. Prior to this point in time they may represent contractual obligations, which – if abnormally large – are reported by a note to the financial statements. Neither the date of the final reading of the debenture by-law nor the date of the debentures establish that a liability has been incurred; a liability arises only when a municipality receives the cash proceeds.

If the proceeds from an issue fall short of the amount needed for the purpose for which the issue was made, the remainder must be included in the budget in the year following the issue or it may be spread over a period of up to five years if OMB approval is obtained.

Any discount on the sale of debentures increases the amount reported as "Capital Outlay To Be Recovered In Future Years", unless the deficiency is financed from another source. If, on the other hand, there is a premium on the issue, the opposite is true, and the amount decreases the "Capital Outlay To Be Recovered In Future Years".

The *Statement of Capital Fund Operations* reports the net proceeds of the debentures – the par value less any discount (or plus any premium). The *Consolidated Balance Sheet* reports the par value of the debentures issued.

E. TREATMENT OF SPECIAL ITEMS

1. AGREEMENTS UNDER THE ONTARIO WATER RESOURCES ACT

Municipalities frequently enter into agreements with the Ministry of the Environment to supply them with water or sewage services. There are two basic types of agreement:

- Service agreement for the supply of water or for the collection, treatment and disposition of sewage.
- Agreement for the construction and operation of a water supply or sewage system.

The difference between the two types of agreement is the nature of the obligation involved.

(a) SERVICE AGREEMENTS

This type of agreement involves a continuing contractual obligation to purchase the service but entails no specific municipal debt. This obligation may govern the level of expenditure for that service for a considerable time in the future. Therefore, it is necessary to disclose full particulars of the agreement by a note to the financial statements reporting the existence of the contract, the term of the contract, the minimum annual payment, the gallonage rate for water or sewage treatment and the amount of expenditure incurred during the year.

(b) CONSTRUCTION AND OPERATION AGREEMENTS

This type of agreement contains a specific long-term liability which must be retired – and until this liability is retired the Government of Ontario retains title to the system. When the liability is incurred it is reported as capital financing on the *Statement of Capital Fund Operations*. The cost of the project is reported as “Capital outlay” under the functional classification “Environmental services” (if for sewage) or “Transfers to others” (if for water).

On the *Consolidated Balance Sheet* the long-term liability due to the Ministry of the Environment is reported as “net long-term liabilities” (after deducting the total value of the Ontario Water Resources Debt Retirement Fund). And the capital cost of the project (less the total value of the Ontario Water Resources Debt Retirement Fund) is reported as “Capital outlay to be recovered in future years”.

It is important to differentiate between the Ontario Water Resources Debt Retirement Fund and the Reserve Fund for Renewals, Replacements and Contingencies. The Debt Retirement Fund is administered by the Ministry of The Environment to repay the municipality’s long-term debt and so it is deducted from that debt for financial reporting purposes. The Reserve Fund for Renewals, Replacements and Contingencies is used by the Ministry of the Environment for any necessary major repairs. Although this reserve fund is under provincial control, it is used for the benefit of the municipality and should be considered a reserve fund of the municipality. The transactions and the fund balance are reported on the *Continuity of Reserve Funds* (if for sewage) or *Waterworks – Continuity of Reserve Funds* (if for water).

Where the Central Mortgage and Housing Corporation (CMHC) is involved, the loan is reported on the same basis as for any other lender. Advances from CMHC are reported as temporary loans until permanent financing is obtained. Debt forgiveness by CMHC – made at the time permanent financing is arranged – is reported as a source of funds on the *Statement of Capital Fund Operations*. The total cost of the project is reported as “Capital outlay” under “Environmental services” (if for sewage) and “Transfers to others” (if for water). Both the permanent financing and debt forgiveness are reported as “Capital financing”.

2. NET LONG-TERM LIABILITIES AND RELATED CHARGES INCURRED UNDER THE LOCAL IMPROVEMENT ACT AND SECTION 362 OF THE MUNICIPAL ACT

Projects under these Acts can be initiated either by a municipality or by a petition from the benefitting ratepayers. Under these Acts, benefitting ratepayers are taxed to pay for a portion or all of the cost of a project. However, the municipality may issue debentures to finance the capital outlay for the project

thus spreading the burden over a period of several years. The municipality recovers the annual debt charges by means of a special charge on the benefitting ratepayers.

Municipalities may pass a by-law to allow the benefitting ratepayers to pay all of their portion of a project’s cost in one cash payment after the debentures are sold. This type of transaction is often termed a “commutation”. Commutations are treated as deferred revenue and are reported as part of “Other current liabilities” on the *Consolidated Balance Sheet*.

Special charges during the year – plus the applicable proportion of the commutations – are reported as revenue, and the debt charges are reported as expenditure on the *Statement of Revenue and Expenditure*. When debentures are issued (or will be issued) to finance the project, the “Capital outlay to be recovered in future years” and the “Net long-term liabilities” are reported on the *Consolidated Balance Sheet*.

3. LIABILITIES UNDER THE DRAINAGE ACT

Projects under this Act are undertaken by a municipality either on its own initiative or after a petition from the benefitting landowners. Drainage works are financed under the Act:

- By special assessments against the land, based on the benefit received from the drainage project.
- From general municipal revenues for the share of benefit to the municipally-owned land from the drainage project.
- By payments in lieu of taxes on land owned by the Governments of Ontario or Canada (or any of their agencies) that benefits from the drainage project.
- By provincial subsidies made under this Act and *The Public Transportation and Highway Improvement Act*.

It is common for a municipality to issue debentures to finance the capital expenditure for the drainage project. In this way the recovery of the expenditure can be spread over several years. The reporting treatment for these liabilities, and their related charges is the same as that for Net Long Term Liabilities and related charges incurred under *The Local Improvement Act* and section 362 of *The Municipal Act*.

4. LIABILITIES UNDER THE TILE DRAINAGE ACT

This Act allows a municipality to issue serial debentures to the Government of Ontario for the purpose of lending the proceeds to landowners, to finance tile drainage projects. The municipality pays the annual debt charges on these debentures and records them as an expenditure on the *Analysis of Expenditure* under the function “Transportation Services – unclassified”. The annual debt charges are recovered from the benefitting landowners and are reported as “Other revenue” on the schedule *Analysis of Revenue*.

5. LIABILITIES PAYABLE IN FOREIGN CURRENCIES

On the *Statement of Capital Fund Operations*, the proceeds from the sale of debentures are reported in Canadian dollars valued at the exchange rate in effect on the date of sale. The *Consolidated Balance Sheet* reports the par value of the issue in Canadian funds. It is reported at this value until maturity and no adjustment is made for year-to-year fluctuations in the exchange rate.

Where long term liabilities are payable in a foreign currency, the amount of the liability is disclosed in *Notes to Financial Statements*. Where there is a material difference between the carrying value and the liability converted at the exchange rate in effect at the date of the *Balance Sheet*, the difference is disclosed in a note.

6. MUNICIPAL GRANTS TO HOSPITALS, UNIVERSITIES AND OTHER INSTITUTIONS

Frequently a municipality assists an institution by making a substantial capital grant. To finance such a grant, the municipality may issue long-term debt. Such debt is reported on the *Capital Fund Balance Sheet* as "Capital Outlay To Be Recovered in Future Years – general municipal activities", and "Net Long-Term Liabilities – general municipal activities".

On the *Statement of Capital Fund Operations* the proceeds of the issue are reported as "Capital financing and capital outlay – transfers to others".

In some cases a municipality agrees to pay a series of annual grants to an institution to assist its capital financing program. Such an agreement is disclosed in *Notes To The Financial Statements*. The note includes the period covered by the agreement, the annual payment, and the amount still to be paid.

BULLETIN

4

RESERVES, ALLOWANCES, RESERVE FUNDS AND
OTHER SPECIAL FUNDS

*a guide for
municipal treasurers and auditors*

Advisory Services Branch
MINISTRY OF TREASURY, ECONOMICS & INTERGOVERNMENTAL AFFAIRS

1974



Contents

I. INTRODUCTION	401
II. RESERVES	401
A. Description	401
B. Purposes	402
1. Working funds	402
2. Contingencies	402
3. Replacement of equipment	402
C. Reporting treatment	402
1. Reserve for working funds	402
2. Other reserves	402
III. ALLOWANCES	402
A. Description	402
B. Purposes	402
1. Allowance for uncollectable taxes	402
2. Allowance for doubtful accounts	402
3. Allowance for loss on property acquired for taxes	402
C. Reporting treatment	402
IV. RESERVE FUNDS	403
A. Description	403
1. Obligatory reserve funds	403
2. Discretionary reserve funds	403
B. Purposes	403
C. Management of reserve fund assets	403
1. Legal requirements	403
2. Restrictions on temporary financing from reserve fund assets	403
D. Reporting treatment	404
V. OTHER SPECIAL FUNDS	404
A. Description and purposes	404
B. Reporting treatment	404

I Introduction

This Bulletin explains when and how allowances, reserve funds and other special funds can be used as tools in the sound financial management of a municipality. The council is responsible for deciding the best use of these tools in its own particular situation.

In the past, the Ministry of Treasury, Economics and Intergovernmental Affairs required municipalities to apply for approval when the council wished to establish, increase or reduce reserves and allowances in amounts exceeding certain limits. The Ministry realises that – within the limits of sound financial judgment – a municipal council is in the best possible position to decide how it should handle its own reserves and allowances. The limits previously set by the Ministry no longer apply. However, there are still statutory restrictions on the use of reserve funds and other special funds.

This Bulletin explains the differences between reserves, allowances, reserve funds and other special funds in detail.

II Reserves

A. DESCRIPTION

A reserve is an allocation of accumulated net revenue*; it has no reference to any specific asset. Estimated liabilities and deferred revenues (such as commutation of local improvement charges) are *not* reserves. A reserve is established for a pre-determined purpose and may be used for that purpose at the council's discretion. It is created by reporting an expenditure in the revenue fund under an appropriate function.

The most common examples of reserves are:

- Reserve for working funds
- Reserve for contingencies
- Reserve for equipment replacement

The *Municipal Act* (sec. 307(2)) requires a municipality to apply to the Ministry of Treasury, Economics and Intergovernmental Affairs for approval to establish reserves not authorized by statute. In the past, the Ministry has insisted on municipalities applying for approval for all reserves other than those for working funds, contingencies or equipment replacement. With the publication of this Bulletin, the Ministry no longer requires application for approval; municipal councils are responsible for deciding when sound financial management demands the establishment of, the addition to, and the reduction from, a reserve. The arbitrary limits formerly set by the Ministry have been eliminated because – in some cases – they may have inhibited good financial management as much as they encouraged it. The council is responsible for deciding what limits are appropriate to sound financial management in each particular case.

*The recommendations contained in section 3260 of the *Canadian Institute of Chartered Accountants Handbook* concerning reserves do not deal with the special problems in the use of reserves by municipal governments and other non-profit organizations. The purpose of the *Statement of Revenue and Expenditure* of a municipality is not to measure profit, but to report the expenditure incurred during the year – and the taxes, subsidies and other revenues raised to meet them. Accordingly, the provisions for reserves which are reflected in the municipal *Statement of Revenue and Expenditure* have the same effect as appropriations from retained earnings in the financial statements of limited liability companies.

III Allowances

B. PURPOSES

While reserves may now be established for any purpose, the three most common are:

1. WORKING FUNDS

In most municipalities accounts have to be paid before taxes, subsidies and other revenue are available to pay them. A municipality can obtain a short-term loan to meet this need – but borrowing incurs interest. In order to reduce – and, if possible, to avoid – short-term borrowing a working fund reserve is the best financial management technique.

2. CONTINGENCIES

Occasionally a municipality faces uncertain liabilities – such as damage claims and unsettled assessment appeals. If these contingencies arise, it may have to make an extraordinarily large expenditure. If a reserve for contingencies is created, the mill rate will not rise unreasonably if the liability materializes.

3. REPLACEMENT OF EQUIPMENT

Major equipment – such as graders and snow-plows – often has to be replaced on a regular basis. In a small municipality such a reserve eliminates the need to levy for the full cost of the equipment in one year, and avoids the resulting fluctuation in the mill rate from year-to-year.

C. REPORTING TREATMENT

Reserves for working funds are reported differently from other reserves:

1. RESERVE FOR WORKING FUNDS

Provisions for working fund reserves are reported as “Financial expenses” on the *Statement of Revenue and Expenditure*. When the amount of a working fund reserve is reduced (that is, when the amount in the reserve exceeds that considered necessary) the resulting reduction is reported as “Revenue – other” on the *Statement of Revenue and Expenditure*.

2. OTHER RESERVES

Provisions for other reserves are reported under the appropriate function on the *Statement of Revenue and Expenditure*. Expenditure incurred for the purpose of the reserve is charged directly against the reserve.

Capital expenditure financed from reserves is reported as “Capital financing – reserve funds and reserves” on the *Statement of Capital Fund Operations*.

However, the position and transactions of each reserve are reported separately on the *Continuity of Allowances and Reserves*. The total amount of reserves is reported as part of “Reserves and reserve funds” on the *Consolidated Balance Sheet*.

A. DESCRIPTION

An allowance provides for an expected loss on an asset. It is created by reporting an expenditure under an appropriate function on the *Statement of Revenue and Expenditure*.

The *Municipal Act* (sec. 307(2)) requires a municipality to apply to the Ministry of Treasury, Economics and Inter-governmental Affairs for approval to establish allowances not authorized by statute. In the past, the Ministry has expected municipalities to apply for approval for all allowances other than those for uncollectable taxes, doubtful accounts and loss on property acquired for unpaid taxes. With the publication of the *Bulletin*, the Ministry no longer requires application for approval; municipal councils and local boards are responsible for deciding when sound financial management demands the establishment of, the addition to, and the reduction from, an allowance.

B. PURPOSES

Allowances serve entirely different purposes from those of reserves. An allowance is used to reduce the reported value of an asset to its expected realizable value.

The three most common examples of allowances are:

1. ALLOWANCE FOR UNCOLLECTABLE TAXES – used to provide for an estimated loss on the collection of unpaid taxes.
2. ALLOWANCE FOR DOUBTFUL ACCOUNTS – used to provide for an estimated loss on the collection of unpaid accounts.
3. ALLOWANCE FOR LOSS ON PROPERTY ACQUIRED FOR TAXES – used to provide for an estimated loss on the sale of property which has been acquired for unpaid taxes.

C. REPORTING TREATMENT

Provisions for allowances are reported under the function “Financial expenses” on the *Statement of Revenue and Expenditure*. When the loss for which the allowance was established occurs, it is charged directly against the allowance. The transactions and position of each allowance are reported separately on the *statement Continuity of Allowances and Reserves*. When the level of an allowance is reduced – when it exceeds the amount considered necessary – it is reported as “Revenue – other” on the *Statement of Revenue and Expenditure*. On the *Consolidated Balance Sheet* the allowance is deducted from the book value of the asset to which it relates and only the net value of the asset is reported.

IV Reserve funds

A. DESCRIPTION

A reserve fund is created by the council of a municipality when it passes a by-law setting aside assets for some specified future use. There are two types of reserve funds: obligatory and discretionary.

1. OBLIGATORY RESERVE FUNDS – created whenever a statute requires revenues received for special purposes to be segregated. Examples are cash payments made by subdividers in lieu of lands dedicated for parks purposes under *The Planning Act* (sec. 33(8)) and net parking revenues under *The Municipal Act* (sec. 352(72e)).

2. DISCRETIONARY RESERVE FUNDS – created whenever a municipal council wishes to earmark revenue to finance any specific future project for which it has authority to spend money (*The Municipal Act* sec. 308(1)). Some examples are: reserve funds for future expenditure for land acquisition; reserve funds for the erection of buildings and other capital projects; and reserve funds for vehicle self-insurance and industrial promotion.

B. PURPOSES

Obligatory reserve funds are used solely for the purpose prescribed for them by statute; they may be used for no other purpose.

On the other hand discretionary reserve funds are used for many different purposes. If handled responsibly, they are useful tools for municipal financial management. A discretionary reserve fund allows the council to actually set aside a certain portion of any year's revenues, so the assets are available when required.

There are two major advantages to discretionary reserve funds:

- They help stabilize the mill rate. In a year when a large amount of capital is required, a previously established discretionary reserve fund enables a municipality to spend money without raising the mill rate or issuing debentures.
- Their assets can be invested to earn income – thus helping to reduce the amount of money to be set aside.

It is highly desirable that the use of discretionary reserve funds be kept as flexible as possible. The use of any reserve fund is restricted to the purpose stated in the by-law establishing it. A two-thirds majority of the council is required to pass this by-law and Ministry permission must be given before a by-law to change the purpose of a discretionary reserve fund may be passed. Therefore, it is simpler to manage discretionary reserve funds established for general functions than those established for specific projects. Flexibility for the future is achieved by keeping the words of the by-law general rather than particular (for example, "recreation" rather than "swimming pool").

January 1974

C. MANAGEMENT OF RESERVE FUND ASSETS

1. LEGAL REQUIREMENTS

Once a reserve fund has been created there are statutory restrictions over the management of the assets of the fund. The major restrictions are*:

- The money set aside for a reserve fund must be paid into a separate bank account. A consolidated reserve fund bank account is allowed if records – adequate to determine the position of each fund – are maintained. This restriction ensures that the advantages of a reserve fund are maintained: the money is kept segregated from the day to day financing of the municipality and is available when required.
- The assets of a reserve fund may be invested only in securities allowed under *The Trustee Act* and the income earned on those investments must be added to the reserve fund.
- The assets of a reserve fund can be used only for the purpose for which the fund was created, unless Ministry approval is obtained to pass a by-law to use them for another purpose.

2. RESTRICTIONS ON TEMPORARY FINANCING FROM RESERVE FUND ASSETS

Reserve funds are not to be considered as a source of working funds. If a municipality continually needs temporary financing, it should establish a reserve for working funds. However, if there is an occasional need for temporary financing, and if the reserve fund assets are available for investment, lending them to the municipality for a short period could be a proper investment. The conditions for investments allowed under *The Trustee Act* must always be met before reserve fund assets are loaned to the municipality.

- There must be evidence of indebtedness. To assure compliance with this condition the municipality must issue a promissory note payable to the reserve fund; the promissory note provides the evidence of indebtedness.
- The investment must be reasonable and proper. If the reserve fund is to invest in its own municipal securities there must be evidence that:
 - the municipality will be able to repay the reserve fund before the money will be required; the promissory note must bear a specific maturity date.

* *The Municipal Act*, section 308.

V Other Special Funds

- the interest rate paid to the reserve fund is reasonable and proper. (Current interest rates for temporary loans from chartered banks are a guide for what is “reasonable and proper.”)
- the amount invested in the municipality is reasonable and proper. (The extent to which the municipality can obtain temporary financing from other sources is a guide.)

The process involved in borrowing reserve fund assets may seem irksome. However, when the council created the reserve fund it took legal steps to restrict the use of those assets. Therefore, if the municipality wants to borrow reserve fund assets it must meet the statutory requirements under which the reserve fund was created.

D. REPORTING TREATMENT

Contributions from the revenue fund for reserve funds are reported under the appropriate function on the *Statement of Revenue and Expenditure* and details are reported on the *Analysis of Contributions and Provisions from the Revenue Fund*. Payments received for obligatory reserve funds are reported directly as revenue of the reserve fund and are not reported as revenue of the revenue fund.

When an expenditure is incurred it is charged directly against the reserve fund and is reported on the *Statement of Continuity of Reserve Funds*.

Capital expenditure financed from reserve funds is reported as “Capital financing – contributions from reserve funds and reserves” on the *Statement of Capital Fund Operations*.

The position and transactions of reserve funds are reported on the *Statement of Continuity of Reserve Funds*. The assets and position of the reserve funds are reported on the *Consolidated Balance Sheet*.

A. DESCRIPTION AND PURPOSES

The most common special funds other than reserve funds are trust funds, and funds to pay future liabilities.

Some examples of trust funds are:

- Endowment funds for the payment of scholarships
- Cemetery perpetual care funds
- Funds held by the administrator on behalf of residents of a home for the aged
- Deposits by a subdivider to guarantee installation of services
- Deposits by a contractor to guarantee the performance of a contract.

The assets of a trust fund are held by – or on behalf of – a municipality or local board. Sometimes the capital of a trust fund cannot be used by a municipality or a local board – although the income is available for a specified purpose. A trust fund is used by a municipality or local board to segregate and administer assets under the specific terms of a statute or trust indenture.

Of the five examples listed above, only cemetery perpetual care funds require comment: *The Cemeteries Act* (sec. 24(1)) and Ontario Consolidated Regulation 81 require a portion of the proceeds from the sale of a burial space to be set aside to provide perpetual care. In the case of municipal cemeteries, this portion is deposited with the municipal treasurer – or with an independent trustee – to be invested and held in perpetuity. The income is paid to the cemetery solely for maintenance purposes.

Sinking funds are the most common example of funds to pay future liabilities. These funds are normally established on an actuarial basis so that contributions, plus earnings, equal the total liability to be paid when it becomes due.

B. REPORTING TREATMENT

The assets of trust funds, and funds to pay future existing liabilities are segregated and earmarked for the purpose for which the funds were established. The transactions and fund balance are reported on the *Trust Fund Statement of Continuity and Balance Sheet*. For certain trust funds – such as endowment funds and cemetery perpetual care funds – there is often a legal requirement to report the capital and income portions of the fund balance separately.

The actual value of the sinking fund is netted against the liability it is to repay and the resulting balance is reported as part of “Net long-term liabilities” on the *Consolidated Balance Sheet*.

BULLETIN

5

CAPITAL

*a guide for
municipal treasurers and auditors*

Advisory Services Branch
MINISTRY OF TREASURY, ECONOMICS & INTERGOVERNMENTAL AFFAIRS

1974



Contents

I. INTRODUCTION	501
II. ACCOUNTING AND REPORTING FEATURES	501
A. Definition of capital outlay	501
B. Capital outlay: its use in municipal accounting	501
C. Accounting classification	502
D. Financial statement presentation	502
III. TREATMENT OF SPECIAL ITEMS	502
A. Proceeds from the sale of capital assets	502
B. Capital subsidies	503
C. Capital levies	503
D. Contractual obligations	503
E. Interest on temporary borrowing for capital purposes	503
IV. MANAGEMENT FUNCTION	503
A. Long-term capital budgeting	503
B. Non-financial records for capital assets	504
1. Land and buildings	504
2. Vehicles and equipment	504
3. Other capital assets	504

I Introduction

This Bulletin is concerned with the management and reporting of capital projects in the municipal context. It explains the differences between reporting capital transactions for a municipality and for a business corporation.

The Bulletin sets out standard concepts and terminology related to capital outlay and capital outlay to be recovered in future years. It is intended to complement **Bulletin 3, Net Long Term Liabilities** which explains the financing of capital projects through long-term debt.

Reports of municipal capital transactions are of significance to ratepayers and other users of local government statistics because they

- measure the municipal expenditure made during the period that provides benefit over future periods of time;
- measure the commitments which must be met out of future revenues.

A municipality's interest in fixed assets is important from the point of view of maintaining physical control and custody. References made later in this Bulletin to non-financial records for municipal fixed assets emphasize how effective control should take place outside the financial statements.

II Accounting and Reporting Features

A. DEFINITION OF CAPITAL OUTLAY

For municipal accounting and reporting purposes the term "Capital outlay" includes one or both of two elements:

- capital expenditure
- transfers of capital funds to other organizations.

Capital expenditure is defined as any significant expenditure incurred to acquire or improve land, buildings, engineering structures, machinery and equipment used in providing municipal services. This expenditure normally confers benefit lasting beyond one year and results in the acquisition of, or extends the life of, a fixed asset.

It includes vehicles, office furniture and equipment. Expenditure on repair or maintenance designed to maintain an asset in its original state is not capital expenditure.

Transfers of capital funds to other organizations is defined as money transferred for capital purposes to local boards, municipal enterprises, hospitals, universities and similar organizations for which the municipality may incur long-term liabilities – regardless of whether or not the project has been permanently financed.

Capital outlay is determined by the nature of the transaction, not by the method of financing. Financing – from the sale of debentures, provincial or federal subsidies, reserves or reserve funds, the revenue fund or from whatever source – is entirely irrelevant in determining whether the transaction is a capital expenditure.

B. CAPITAL OUTLAY: ITS USE IN MUNICIPAL ACCOUNTING

Municipal management is concerned about how to finance expenditure for a given period. It budgets and manages on a cash-needs basis; to do so, it must have financial information geared to its requirements. Management of a business corporation is concerned with maximizing earnings. It matches total costs with revenues to determine earnings over a given period. For this reason, the accounting for municipal capital transactions differs from that used by business corporations. Municipal capital outlay may be charged either against current revenues or, by issuing long-term debt, against future revenues. If long-term debt is issued to defer the payment of capital outlay – the debt charges will be reported in the periods in which they are paid.

Typically in a business corporation, capital expenditure is charged to future years by amortizing the cost of a capital asset over its useful life. In a municipality, the method of financing capital outlay determines the accounting period to be charged with the expenditure.

The disclosure of the net value of capital assets is important for a business corporation because it shows the extent of costs to be applied to future years. On the other hand, in a municipality, the reporting of expenditure on capital outlay is dependent on the method of financing, instead of the life of the asset. Therefore, for municipal financial reporting purposes, no value is attached to capital assets. The key factor in reporting municipal capital outlay is the extent of expenditure to be recovered from present and future revenues.

C. ACCOUNTING CLASSIFICATION

Accounting for capital projects is designed to enable capital expenditure information to be classified:

- by function
- by project
- by object (land, building, equipment)
- by the nature of the expenditure within the project (payments to contractors, professional fees, etc.).

Similarly, capital financing is classified:

- by project
- by the source from which it was received (debenture proceeds, subsidies from other governments, reserves, reserve funds or the revenue fund etc.).

For external reporting purposes, functional and object classification is used; for internal management purposes, project analysis is more useful.

D. FINANCIAL STATEMENT PRESENTATION

The financial transactions and the position of the capital fund are reported on the *Statement of Capital Fund Operations* and the *Consolidated Balance Sheet* and on their supporting schedules. These financial statements disclose:

- the details of capital outlay and capital financing for the year being reported
- the liquidity of the capital fund

- the extent to which general municipal revenue is committed to repay debt already incurred by the municipality – and the extent to which debt is to be recovered from municipal enterprises and from special charges
- the net long-term liabilities of the municipality

When accounting for capital outlay, the actual amounts incurred by the municipality are reported on the *Statement of Capital Fund Operations* under the appropriate functions. The amount financed – or to be financed – from long-term debt is reported on the *Consolidated Balance Sheet* as “Capital outlay to be recovered in future years.” On the *Analysis of Assets* “Capital outlay to be recovered in future years” is further analysed into portions to be recovered “From general municipal revenues”, “From special charges” and “From municipal enterprises”. As long-term debt is repaid “Capital outlay to be recovered in future years” is reduced.

III Treatment of Special Items

A. PROCEEDS FROM THE SALE OF CAPITAL ASSETS

When an asset is sold and any debentures used to finance it are outstanding, there are three alternative ways of disposing of the proceeds. They may be used to repay those debentures, or to meet the annual payments of principal and interest on those debentures, or – if the council so decides and the Ontario Municipal Board (OMB) gives its approval – to meet new capital expenditure (*The Municipal Act*, section 313).

The recommended accounting and reporting treatment for the proceeds from a sale of capital assets is:

- Where the proceeds are to be applied against future annual payments of debt charges, they are credited to a deferred revenue account, and this account is reduced by the amount of the annual debt charges as they are incurred.
- Where the proceeds are to be used to meet new capital expenditure, they are reported on the *Statement of Capital Fund Operations* as “Capital financing – Other”, and on the *Consolidated Balance Sheet* as “. . . unapplied capital receipts”. As the proceeds are used to finance new capital expenditure, this amount of “. . . unapplied capital receipts” will be reduced until it has all been used.

Where there are no debentures outstanding for the asset sold, and the proceeds involved are material, the second procedure is recommended. If the council anticipates no capital expenditure in the immediate future, it may decide to treat the sale proceeds as income of the revenue fund.

B. CAPITAL SUBSIDIES

Capital subsidies are those subsidies received for capital expenditure. They are reported under "Capital financing – Contributions from other governments" on the *Statement of Capital Fund Operations*.

The accrual basis of accounting is used for subsidies in the same way as for the related capital expenditure. Any difference between the amount estimated and the amount received is corrected by adjusting the capital subsidy figure reported on the following year's financial statements.

C. CAPITAL LEVIES

Municipalities often include an amount in their revenue fund budgets to finance some of the year's capital expenditure. This procedure equalizes the burden of capital expenditure and reduces reliance on long-term borrowing.

Financial statements reflect the use made of the capital levy. The amount raised is reported on the *Statement of Revenue and Expenditure* as "Revenue- taxation" and the corresponding contribution for capital expenditure is classified by function. Amounts transferred to the capital fund are reported as "Capital financing – contributions from the revenue fund" on the *Statement of Capital Fund Operations*.

D. CONTRACTUAL OBLIGATIONS

If contractual obligations are extraordinarily large in comparison to the municipality's normal operations they are disclosed in *Notes to Financial Statements*. Examples of such obligations are contracts for major expressway construction, urban renewal and large capital grants to a hospital or university. The proposed financing should also be disclosed in order to indicate the effect, if any, on the financial position or future operations of the municipality.

E. INTEREST ON TEMPORARY BORROWING FOR CAPITAL PURPOSES

There are two methods of treating interest on temporary loans:

- to charge the interest against current municipal revenues in the year in which they are incurred.
- to identify the interest incurred with specific capital projects and to charge it to each project.

The second method is preferable when the cost of the project is to be recovered from another body or a specified group of ratepayers.

IV Management Function

A. LONG TERM CAPITAL BUDGETING

Most municipalities have recognized the need for capital budgets because the impact of capital outlay on the total municipal revenue is significant. Municipal councils are often expected to provide a level of service, the capital costs of which may exceed the financial resources available. Priorities have to be placed on capital expenditure; they are set by means of the capital budget. The capital budget details all the capital projects approved by the council for the time period covered – regardless of the source of financing. All sources of proposed capital financing for the period are shown, including the sale of debentures, subsidies, current funds, reserves and reserve funds and any other sources. A capital budget also shows the impact of the proposed projects on the total municipal revenue. Factors to be considered include: amounts needed to repay long-term debt already issued, amounts needed to repay long-term debt expected to be issued, operating costs of facilities planned in the budget, and lost taxation revenue if the municipality purchases tax-producing property.

A municipality's capital budget may extend over any time span, but five years is the minimum period suggested. The capital budget is reviewed and updated annually in view of changing priorities and contemporary information on taxable assessment, expenditure, revenue and interest rates for long-term borrowing.

A carefully-designed long-term capital budget provides these benefits:

- A long-term capital budget enables a municipality to plan its financial development over a number of years.
- Projects are not considered in isolation. The council – while considering each capital project on its own merits – also determines its priority in relation to the overall long-term program. All proposed expenditures are summarized by year – and accompanied by data on capital costs, operating costs and proposed methods of financing.
- Projects are carried out within the limits of a municipality's financial resources for capital expenditure. Capital outlay and financing are co-ordinated.
- Preliminary stages – processing of contracts and tenders, obtaining necessary approvals, hiring and training technical staff, purchasing land – are carried out in an orderly fashion.
- Everyone concerned with gathering, presenting and evaluating relevant information, and with setting priorities is forced to consider the cost, benefits and timing of each individual capital project.
- Information is available for the preparation of the municipalities' current revenue budget – debt charges, operating costs and revenues etc. – for debenture prospectuses, and for the Government of Ontario.

2. VEHICLES AND EQUIPMENT

All records need to be in sufficient detail in order that an asset can be easily located, and identified. Details generally included are description, engine or machine number, model number, date of purchase, cost and supplier, normal location, estimated life and insurance value, annual mileage, servicing costs and intervals, repair history and mechanical data.

3. OTHER CAPITAL ASSETS

All other capital assets are engineering structures such as roads, sidewalks, bridges, sewers and watermains. Detailed records of these capital assets are needed for:

- maintenance purposes
- performance statistics
- other engineering purposes

B. NON-FINANCIAL RECORDS FOR CAPITAL ASSETS

Although municipal capital assets are not reflected on the *Consolidated Balance Sheet*, a municipality needs to keep a record of its assets. Adequate control can be maintained over their custody and proper insurance coverage can be obtained. The type of record varies for each different class of asset.

1. LAND AND BUILDINGS

Records should include details of location, description (if necessary, referring to maps), date and cost of acquisition, the purpose for which land and buildings were purchased or held, appraised and insured values, and any other relevant information.

